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CHEMICAL MANUFACTURERS ASSOCIATION

February 29, 2000

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The Honorable Vernon A. Williams, Secretary
Surface Transportation Board
1925 K Street, NW Suite 700
Washington, D.C. 20423-001

Re: STB Ex Parte No. 582, Public Views on Major Rail Consolidation

Dear Secretary Williams:

Enclosed are the original and 10 copies of the comments of the Chemical Manufactures Association in this proceeding. Also enclosed is a 3.5" disk containing this file in WordPerfect 5.x format.

Sincerely,

Thomas E. Schick

Thomas E. Schick
Distribution Council

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BEFORE THE SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582

PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

COMMENTS

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CHEMICAL MANUFACTURERS ASSOCIATION

FEB 29 2000

Part of Public Record

March 8, 2000

The Chemical Manufacturers Association ("CMA") is pleased to be here today with colleagues from the chemical and plastics sector to present our views on the evolving structure of the North American railroad industry. CMA commends the Surface Transportation Board ("Board") for holding these timely hearings. The public interest requires an examination of the Board's rail merger policy in light of at least four significant factors:

- the recently concluded round of major rail consolidations;
- the adverse effects of those transactions on shippers;
- the pending combination of the Canadian National ("CN") and Burlington Northern Santa Fe ("BNSF") rail systems; and – perhaps most significant –
- the likelihood that the BNSF-CN transaction will trigger another round of major rail mergers.

CMA Members Depend on Rail Transportation

CMA's 191 member companies account for more than 90% of this country's productive capacity for basic industrial chemicals. CMA's membership ships products by various transport modes. The reality, however, is that in many specific situations, chemicals must move by rail due to product characteristics, distance, customer preferences, shipment size, and other factors.

The chemical industry therefore depends on the railroads for the safe and efficient delivery of a wide array of raw materials and finished products. Each year, about 140 million tons of chemicals and allied products are transported by rail. This chemical traffic, which ranks second only to coal in terms of rail tonnage originated, provides the carriers with approximately $5 billion in annual freight revenue. CMA members invest further in the rail industry by maintaining their own fleets of tank cars (with an estimated replacement value of $7 billion) and by providing other rail-specific facilities and equipment.

Safety is of paramount concern to the railroads as well as to chemical shippers. CMA is proud to have all Class I carriers as partners in our Responsible Care® initiative. But reliable service and reasonable rates are also important to CMA members, who must constantly meet the needs of their own customers in extremely competitive domestic and global markets. Of special note, as the Board considers rail policy on a North American basis, is the fact that many CMA members have operations, customers, and/or suppliers in Mexico and Canada.

The Rail Industry Lacks Competitiveness

Last year, CMA surveyed its members about their rail service. The stark results highlight why rail competitiveness is so important to the chemical industry. At 63% of the rail-served plants where chemicals are produced, only one railroad has access. In other words, there is absolutely no competition at nearly two-thirds of chemical plants sites. To be clear, this level of captivity was measured after CSX and Norfolk Southern established the Shared Assets Areas as part of their Board-approved Conrail transaction.

CMA's survey also asked members about the commercial effect of being captive. Based on the responses of members with experience at both captive and non-captive sites, CMA found that captive chemical shippers generally pay from 15% to 60% more for comparable rail service, with an average premium of 25% at captive locations. Not quantified in CMA's survey, but also significant, is the adverse effect of monopoly power on service quality. At 63% of the chemical plants in this country, the single serving railroad can essentially take its customer for granted. Further, CMA's survey actually understates the lack of rail competitiveness, because the benefits of two-carrier access at any plant are virtually eliminated whenever the other end of a particular movement is captive to one of the two serving railroads.

Competition is the key to economic success. The chemical industry knows from its own experience that competition improves customer service, drives innovation, reduces prices and costs, and stimulates investment. For example, having an unimpeded choice between carriers enhances a shipper's ability to receive consistent transit times. Competition therefore guides CMA's rail policy. In addition to advocating competition before the Board, CMA strongly supports pro-competitive rail legislation that was introduced in the Senate and the House of Representatives during the 106th Congress.

These Comments Do Not Address the BNSF-CN Transaction

As the Board has made clear, these hearings are not being held to take "evidence" on the BNSF-CN combination. Recognizing the need for enhanced competition in the rail industry, CMA has already announced that it opposes the BNSF-CN transaction. In opposing that transaction, CMA will ask the Board – if the BNSF-CN combination is determined to be otherwise consistent with the public interest – to impose one pro-competitive condition. The CMA Condition would grant every currently captive shipper on BNSF and CN lines in the United States the permanent right to receive service from a second railroad.

Regarding the broader scope these hearings, Chairman Morgan has asked shipper representatives to address five questions. CMA's answers follow.

Question #1 – Should there be more rail mergers?

Whether there should be further consolidation among railroads depends entirely on the conditions that are attached to each merger. On December 28, the Board properly waived its "one case at a time" rule in the BNSF-CN proceeding, citing the prospect of "yet another full round of major transactions." In addition to the Board's stated concern about "downstream" and "crossover" effects, most knowledgeable observers anticipate that there will be only two major rail systems in North America. Whether or not that outcome is inevitable, CMA believes that all future rail mergers must be conditioned to assure that every rail shipper location has meaningful and permanent competition.

Question #2 -- If mergers are good, when should they happen?

CMA does not agree with the public position of some railroads, which have characterized the BNSF-CN transaction as "premature." The right time for any major rail consolidation will be after the Board has adopted a new policy that requires future mergers to create truly effective competition for all shippers. This proceeding is the Board's last chance to adopt such a policy before it begins to assess the final round of rail mergers. Now is the time for the Board to adopt rules that will create and maintain workable competition.

Question #3 – What is the impact of mergers on finances, rates, service, capacity, and infrastructure?

A columnist recently observed that the "mega-mergers" have already occurred and the next round of rail transactions should be called "giga-mergers." The mega-mergers had the following effects:

- Finances – Stock prices of Class I railroads have fallen drastically despite their mergers. Wall Street's message can be interpreted in various ways, but it is difficult to see those stock prices as an endorsement of the mega-mergers and the current performance of the carriers.
- Rates – Major Class I railroads have recently announced that they intend to raise rates, which is certainly not beneficial to shippers. Price increases were not featured in the merger applications that the Board reviewed.
- Service – Most recent rail mergers have subjected shippers to service disruptions, including some that have been particularly harsh on CMA members. In addition, rail operational problems have had adverse impacts on customers and employees of the chemical industry.
- Capacity and Infrastructure – Railroads have pointed to capacity constraints, at least on portions of their systems, as the cause for the rate increases and service difficulties discussed above. Mergers have not eliminated concern about the rail industry's ability to invest in needed infrastructure improvements.

Today, after the mega-mergers, the rail industry looks unstable. Some pessimists may think that the railroads have only two options:

1. cut costs by curtailing investment, which will ultimately degrade service, or
2. increase revenues by raising rates at the expense of captive shippers.

But the Board can take a more optimistic view as its establishes new criteria to review future rail consolidations. Competition makes all industries better. In the chemical industry, for instance, competition constantly spurs innovation and reduces costs. Companies must invest in infrastructure to create the capacity to meet customer expectations. In contrast, customer service has relatively little meaning in the rail industry because captive shippers have no meaningful alternatives.

Question #4 – What is the appropriate regulatory approach to review future rail mergers?

First, the Board must incorporate its waiver of the "one at a time" rule into its permanent regulations governing rail consolidations. It is essential that all future rail mergers be uniformly assessed in light of the expected two-railroad scenario. No merger applicant or other party should be advantaged – or disadvantaged – by the particular sequence in which mergers are proposed. In other words, the same rules and conditions should apply to all giga-mergers.

Second, the Board must adopt policies and remedies that will give each rail-dependent shipper a meaningful choice between carriers at all origins and destinations as the likelihood of two systems evolves. This change will require the Board to promote competition more aggressively than in past rounds of mergers. Only preserving some form of competitive access for a narrowly defined set of "two-to-one" shippers will not be sufficient in the next round of consolidations. In short, the Board must not leave any shippers monopolized. Something like the condition that CMA has proposed for the BNSF-CN transaction is likely to be presented by shippers in other merger proceedings. Without such conditions, currently captive shippers will remain captive while other shippers lose competitive options.

Third, the Board must adopt and implement post-merger regulatory policies that work in harmony with pro-competitive merger conditions. For example, single-system rail service certainly offers potential benefits to many shippers. Yet the Board's "bottleneck doctrine" clearly allows railroads that expand by merger to eliminate competitive routings with shippers generally having no practical recourse. The lesson of the bottleneck cases is that pro-competitive aspects of mergers must also be upheld in subsequent rulings. If statutory changes are necessary to create and maintain true competition in a two-railroad environment, the Board should clearly recommend such legislation to Congress in the context of reauthorization.

Question #5 – How should the Board examine the evolving North American rail network?

With NAFTA trade growing and most industries competing on a global basis, it is essential that major rail consolidations be reviewed on a North American basis. US ports compete with Canadian ports. US farmers compete with Canadian farmers. US manufacturers compete with Canadian manufacturers. US rail lines compete with Canadian rail lines. Consolidations must not be allowed to erode the few pro-competitive tools available to shippers in either country. In fact, the Board should take the broadest possible view of competitive impacts and operational issues.

CMA coordinates its rail competitiveness advocacy with the Canadian Chemical Producers Association. Governments must also cooperate in order to examine major rail consolidations on a comprehensive North American basis. The Canadian process, however, does not provide a counterpart to Board's jurisdiction and procedures. Further, comparing Canada's competition authorities the Department of Justice and the Federal Trade Commission, there remains a possible mismatch, because those agencies play a limited role under US railroad law. Therefore it is critical that both governments work closely to promote rail competitiveness.

Conclusion

CMA sincerely appreciates the opportunity to comment in these proceedings. In summary, the US chemical industry urges the Board to adopt appropriate policies and procedures for reviewing future major rail consolidations. To successfully protect the public interest, the Board must apply consistent rules in reviewing all such mergers, must substantially broaden the pro-competitive relief applied in such transactions, and must assure that post-merger regulatory decisions ensure real competitive alternatives for all rail shippers.